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August 7, 1989

To: Jim Larocco, ECON

From: William Brekke, FCS

Subject: Submission For Senator Rudman's Visit

There are two critical questions confronting American companies today. The first question is the bleak economic picture which I will leave for the ECON section. The second question is whether or not the direction of China's commercial policy will parallel its political march into the past. Will the decision making process return to the bureaucratic fashion of 1985 or will China continue its reform movement? The stakes are high.

From the American commercial perspective, China's brief opening to the west has been marked by a growing spirit of reform which is best highlighted by the twenty-two Articles on foreign investment issued in October of 1986, less than three years ago. Since then, we have seen successive advances on the Chinese side. A year ago China passed a new enterprise law which separated the party from enterprise management. It was anticipated that by the end of this year, two more milestones would be passed with the enactment of a law to allow foreigners to be chairmen of joint venture companies and a separate law providing copyright protection. In short, China's reformers were making major progress towards becoming a nation with an objective set of business laws. Will the hardliners and the party apparatus put a stop to this?

At the same time, major American companies have been testing the investment environment. With the exception of the energy sector, the joint ventures have been small operations designed to gain experience. The experience to date has been favorable to the point that FCS is aware of at least \$1.5 billion dollars of major capital investments in the aircraft, automobile, electronics and petrochemical industries that were being negotiated before June. This demonstrated significant confidence in a market which has been open for such a short time.

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Now, plans for major investment in China are on hold. If the hardliners stop the movement towards a market economy with a modern legal code and persist in moving back to using administrative controls as the tool to manage the economy, U.S. firms will lose interest in investing in manufacturing ventures.

Americans have always had difficulty understanding the decision making process in China. So far, the central government has been fighting for a year to recentralize decision making. As the economy moves toward stagnation and the government is divided about its policies, provincial officials are once again reminded that "the heavens are high and the emperor is far away." Strong provincial leaders will cut their own deals and the South will move farther from the center. The average American company cannot accept the aggravation and uncertainty of dealing in the gray area between stated central government policy and provincial power plays.

The questions Senator Rudman should ask are:

"Will China proceed with legal reform allowing foreigners to serve as chairmen of joint ventures? "What about copyright protection ?"

"What concrete assurances can the Chinese government give to demonstrate it's commitment to economic reform ?" (examples: price reform, reduction of subsidies to state corporations).

It is estimated tht several billion RMB must be injected into the banking system to help resolve the current credit shortage. "What plan does the Peoples Bank of China have to meet this problem ?"

"Why should a U.S..company invest in China under current conditions?"